IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, A. D. 1940.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

DULUTH, MISSABE AND NORTHERN RAILWAY COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

THE DULUTH AND IRON RANGE RAIL ROAD COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

SPIRIT LAKE TRANSFER RAILWAY COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

OLIVER IRON MINING COMPANY, Respondent.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

PROCTOR WATER & LIGHT COMPANY, Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

STATEMENT OF THE CASE.

The facts of the five cases are, we believe, stated adequately in the foregoing petition for writs of certiorari.

The controlling questions in these cases are federal questions. The federal jurisdictional aspects of these cases have been covered in Sections A, B and C of the jurisdictional statement.

ARGUMENT.

QUESTIONS I and II.

Questions I and II may be conveniently discussed together.

QUESTION I.

The Minnesota Corporate Franchise Tax Act, Chapter 405, Laws 1933, is measured by net income and determined by gross income. Railroad and other corporate gross income is differentiated, the distinction between them being "income derived from the exercise of the corporate franchise within the scope of railroad ownership or operation and that from its exercise without such scope." In 1933, pursuant to the Act of Congress of June 16, 1933, "Emergency Railroad Transportation Act 1933", 48 Stat. 220, defendant received from the United States $7,774,804.19 belonging to the United States, to which defendant, prior to said Act of Congress, had no title or interest legal or equitable.

Of this amount of $7,774,804.19, the sum of $5,808,256.61 consisted of trust funds belonging to the United States, held by defendant as trustee for the United States, transferred to the United States at various times during the years 1924 to 1930, pursuant to the Act of

Congress of February 28, 1920, "Transportation Act 1920", 40 Stat. 488.

The question is whether or not the receipt of said sum of $5,808,256.61 by defendant under the provisions of said Act of Congress of June 16, 1933 constitutes gross income derived from the exercise of defendant's corporate franchise without the scope of railroad ownership or operation.

QUESTION II.

(The first paragraph of Question II is the same as the first paragraph of Question I and is here omitted for the sake of brevity.)

Of this amount of $7,774,804.19, the sum of $1,966,-547.58 consisted of accretions or earnings on moneys belonging to the United States, and which had never at any time been in the hands of the defendant.

The question is whether or not the receipt of said sum of $1,966,547.58 by defendant under the provisions of said Act of Congress of June 16, 1933, constitutes gross income derived from the exercise of defendant's corporate franchise without the scope of railroad ownership or operation.

Points I and II may be conveniently discussed together.

POINT I.

(1) The Supreme Court of Minnesota erred in failing to give due effect to the Act of Congress of 1933, 48 Stat. 220, in failing to properly construe it and in failing to hold that the $7,774,804.19 income received by defendant, Duluth, Missabe and Northern Railway Company from the United States in 1933 was created by Congress and that its nature was determined by Congress.

(2) The Supreme Court of Minnesota erred in failing to give due effect to the Act of Congress of 1920, 41 Stat. 488, in failing to properly construe it and in failing to hold and recognize that said Act of Congress accomplished a complete cut-off and severance of the title and interest of defendant, Duluth, Missabe and Northern Railway Company in and to the funds transferred by it to the general railroad contingent fund.

(3) The Supreme Court of Minnesota erred in failing to give due effect to the decision of the United States Supreme Court in the case of **Dayton-Goose Creek R. Co. v. U. S.**, 263 U. S. 456, 44 S. Ct. 169, 68 L. ed. 388, in failing to follow and apply it and in failing to hold and recognize that the Act of Congress of 1920, as construed and interpreted by the United States Supreme Court in said case, sustained said Act as accomplishing a complete cut-off and severance of the title and interest of defendant, Duluth, Missabe and Northern Railway Company, in and to the funds transferred by it to the general railroad contingent fund.

(4) The Supreme Court of Minnesota erred in holding that the sum of $5,808,256.61 was derived from the exercise of defendants' corporate franchise within the scope of railroad ownership or operation.

(5) The Supreme Court of Minnesota erred in holding that "the repayment amounts to nothing more than the return to defendants of their own railroad earnings. The restoration reinstated the earnings in their original status."

POINT II.

(Sections (1), (2), (3) and (5) of Point II are the same as Sections (1), (2), (3) and (5) of Point I and are therefore omitted for the sake of brevity.)

(4) The Supreme Court of Minnesota erred in holding that the said sum of $1,966,547.58 was derived from the exercise of defendant's corporate franchise within the scope of railroad ownership or operation.

POINTS I. AND II. SUMMARY.

1. Plaintiff's cause of action against Duluth, Missabe and Northern Railway Company is measured and determined by the net income of defendant. Net income is determined by gross income.
2. The item of $7,774,804.19 of gross income of defendant Duluth, Missabe and Northern Railway Company is an essential and substantial element of plaintiff's cause of action.
3. This portion of defendant's income and this element of plaintiff's cause of action is created by, and the nature of the element is determined by, Acts of Congress.
4. Non-railroad income is includable under the Minnesota Income and Franchise Tax Act.
5. The recapture fund, principal and accretions, is non-railroad income.
6. Income was differentiated under the Minnesota Act as construed by the state supreme court.
7. Under this differentiation non-railroad income is income derived from the exercise of the corporate franchise without the scope of railroad ownership or operation.
8. A distinctive character of the exercise of the corporate franchise is required under the Minnesota Statute in exercising the corporate franchise for railroad purposes.
9. The corporate franchise was not exercised for railroad purposes in the acquisition of any part of the $7,774,804.19 received from the United States.

10. The state supreme court placed all of this income in the category of railroad income.
11. The state supreme court erroneously construed the Acts of Congress.
12. The state supreme court must construe the Acts of Congress correctly.
13. Failure to do so raises a federal question.
14. The state supreme court expressly or by necessary intendment passed upon petitioner's federal claims relating to the Acts of Congress.
15. However, the federal questions involved were raised by both sides from the beginning of the litigation. Plaintiff specially set up the federal questions relating to the Acts of Congress.
16. The rights of petitioner specially set up, passed on by the state supreme court and denied to the petitioner, included the following:
    (a) The court failed to give due effect to the Act of Congress of 1933;
    (b) The court failed to properly construe said Act;
    (c) The Court failed to give due effect to the Act of Congress of 1920;
    (d) The court failed to properly construe said Act;
    (e) The court failed to give due effect to the case of Dayton-Goose Creek R. Co. v. United States;
    (f) The court failed and refused to hold that plaintiff was entitled to have all non-railroad income included as a part of its cause of action;
    (g) The court failed and refused to hold that there had been a complete cut-off and severance of the payments made by defendant to the United States for the years 1922 to 1929 amounting to $5,808,256.61;

(h) The court failed and refused to hold that the Act of Congress of 1933 was confirmatory of said complete cut-off and severance;

(i) The court failed and refused to hold that the accretions amounting to $1,966,547.58 had not even passed through the hands of defendant until the distribution by Congress in 1933;

(j) The court failed and refused to hold that the receipt by defendant from the United States of the $7,774,804.19 in 1933 was due solely to the Act of Congress and not to any exercise of the corporate franchise of defendant for railroad purposes.

17. This is not a case where the legislature undertook to characterize certain non-railroad income as railroad income.

18. There is no adequate non-federal ground for the state supreme court's decision on the points here involved.

19. The United States Supreme Court is not concluded by the state court's interpretation of the facts involving the funds received by defendant from the United States.

20. The other defendant corporations are affected in connection with the issue of consolidated return.

POINTS I. AND II. ARGUMENT.

For convenience and brevity we are combining in this argument the interrelated subdivisions of Points I and II.

For the sake of brevity, we here refer to our jurisdictional statement at page 10, et seq., supra, and ask leave to incorporate the same herein. We shall here especially discuss points 5, 6 7, 8, and 9 of the above Summary.

We shall now develop here in more detail our position that the $7,774,804.19 paid by the United States to defendant, Duluth, Missabe and Northern Railway Company, the so-called principal as well as the accretions, is non-railroad income.

The differentiation of railroad and non-railroad income under the Minnesota Income and Franchise Tax Act as construed by the state supreme court.

The Minnesota Income and Franchise Tax Act contains no express differentiation of railroad and non-railroad income. The language of the Act is all inclusive but the state supreme court construing the Act says that the purpose of the legislature in not exempting railroad corporations **"must have been to assure taxation of any income not attributable to railroad ownership or operation."** 207 Minn. at page 625, 292 N. W. at page 405. (Emphasis Supplied.)

Accordingly, pursuant to this legislative purpose to assure taxation of income not attributable to railroad ownership or operation the state supreme court differentiates railroad income from non-railroad income.

In the opinion of December 29, 1939, 207 Minn. 618, 624, 625, 292 N. W. 401, 405, that court said:

> **"If a railroad exercise its corporate franchise for railroad purposes and also for non-railroad purposes that part of its exercise for non-railroad purposes cannot escape taxation.** It follows that railroads may not be subject to the franchise tax imposed by c. 405 measured by income from railroad ownership or operation because for such exercise of the franchise the gross earnings tax is exclusive, but that **they are subject** thereto **insofar as the franchise is exercised,** whether ultra vires or not, **for other than railroad purposes.** That part of the franchise so exercised is as separable, as much subject to ordinary taxes, as is any non-railroad property. **The purpose of the legislature in not listing railroads among the exempt must have been to assure taxation of any**

income not attributable to railroad ownership or operation." (Emphasis Supplied.)

In its December 29, 1939, opinions in these cases, supra, 207 Minn. page 624, and 292 Northwestern page 404, the state supreme court said:

> "Any property owned by the railroad, but used **for a non-railroad purpose,** is subject to ordinary ad valorem property taxation. County of Todd v. St. P. M. & M. Ry. Co., 38 Minn. 163, 36 N. W. 109; State v. Minnesota & I. Ry. Co., 106 Minn. 176, 118 N. W. 679, 1007, * * *." (Emphasis Supplied.)

In the same opinion, 207 Minnesota, at page 624, and **292 Northwestern,** at page 405, the court said:

> "**Holding that the franchise is property and that a tax upon it is a property tax,** we must also hold, in accordance with prior holdings as to property not owned or used for **railroad purposes,** that such property is subject to ordinary taxation. To do otherwise would cause inconsistency with well settled rules in this state. City of St. Paul v. St. P. M. & M. Ry. Co., 39 Minn. 112, 38 N. W. 925; County of Ramsey v. C. M. & St. P. Ry. Co., 33 Minn. 537, 24 N. W. 313; State v. N. W. Tel. Exch. Co., 84 Minn. 459, 87 N. W. 1131. * * *"[9] (Emphasis Supplied.)

---

[9]**The County of Todd case,** cited above by the state supreme court in its opinions of December 29, 1939, in the instant cases, is one of a considerable number of decisions by the Minnesota Supreme Court that throws light on the meaning of "railroad purposes." At pages 166 and 167 of the opinion in the County of Todd case the court said:

> "No very precise rule can be laid down by which it can be determined, in all cases, whether land acquired for railroad purposes is or is not within such an exemption. **The mere fact that it was acquired and used for purposes connected with the road would not necessarily determine its exemption.** Many branches of industry might be made serviceable in connection with the operations of a railroad, and property be devoted to various uses, which could hardly be supposed to have been contemplated, when the corporation was created, as being within the scope of its powers. Such might be the case with respect to the purchase and working of iron mines, forges, the rolling-mills, the erecting of residences for the use of its officers and employees, under ordinary circumstances; the building up of towns along the route to affect the location of centres of popu-

In the opinion of April 26, 1940, 207 Minnesota, at page 639, 292 Northwestern, at page 412, the state supreme court discussed the differentiation of railroad and non-railroad income. It said that the phrase "non-operating income" was not appropriate "to distinguish non-railroad income from that derived from the exercise of the corporate franchise for railroad purposes." That **"the distinction should lie between income derived from the exercise of the franchise within the scope of railroad ownership or operation and that from its exercise without such scope."** The court suggests the use of the phrases "railroad income" and "non-railroad income" to indicate this differentiation. (Emphasis Supplied.)

The corporate franchise was not exercised for railroad purposes in the acquisition of the $7,774,804.19 from the United States.

The corporate franchise "to be" is exercised in merely "being."

The corporate franchise "to do" of a railroad corporation is exercised when powers contained in the articles of incorporation are exercised for **railroad purposes.** Obviously the exercise for railroad purposes is not intended to include merely "being" nor is it intended to include such exercise as is essential to every transaction, whether railroad or otherwise.

A distinctive character of exercise is contemplated and described by the words "for railroad purposes."

---

lation and business, and thus to promote the business and the interests of the company. * * *

"The purchase of the lands in question could not, we think, be deemed, in any proper sense of the word, necessary for the prosecution of this enterprise, nor was it such an ordinary appropriation of property to the purposes of the railroad as to come within the reason and scope of the exemption." (Emphasis supplied.)

No **distinctive** character of exercise of the corporate franchise of defendant was required in the receipt by defendant from the United States of the sum of $1,966,547.58 accretions to the general railroad contingent fund owned by the United States. Nor was any such **distinctive** character of exercise required in receiving the other portion of the $7,774,804.19 from the United States in 1933.

The fact that in 1922 or 1929 defendant had received railroad income of which a portion had been transferred to the United States pursuant to the act of 1920 furnishes no basis for defendant's claim that the payment by the United States in 1933 was derived from the exercise of the corporate franchise for railroad purposes in 1933. A simple illustration will show that such superficial or figurative relationship will not avail defendant. E.g. a railroad earns income from its railroad business. It segregates a portion of net earnings and invests it in industrial bonds. It receives income from these bonds. The corporate franchise is, of course, exercised in receiving and collecting a check for the interest but that is **not** the exercise of the corporate franchise "for railroad purposes." The income from the bonds is **not** "derived from the exercise of the franchise **within the scope of railroad ownership or operation.**"

The state supreme court has recognized that such interest is **not** "derived from the exercise of the franchise within the scope of railroad ownership and operation" by its April 26, 1940, decision citing **State v. N. P. Railway Company**, 139 Minn. 473, 167 N. W. 294, and **State v. G. N. Railway Company**, 139 Minn. 469, 167 N. W. 297, which involved the taxation of investments made from railroad earnings.

The Minnesota Supreme Court recognizes that the mere fact that the investment **once came** from railroad

earnings, that is, from the exercise of the corporate franchise within the scope of railroad ownership and operation, **does not stamp the income** from such investment with the character of income derived from the exercise of the corporate franchise within the scope of railroad ownership and operation. If it were otherwise, then **no** investment could ever produce non-railroad income. The court clearly makes a distinction between income from investment on the one hand and income from direct railroad operations or income produced by working capital on the other hand.

The income amounting to $7,774,804.19 was derived solely from the Act of Congress of 1933. **No** exercise of defendant's corporate franchise for railroad purposes was required nor involved in creating this income.

If the word "derived" be construed to mean mere receipt, then the receipt was derived **not** from exercise of corporate franchise for railroad purposes but from the mere exercise of the corporate franchise without the qualification "for railroad purposes" and without reference to purposes, railroad or otherwise. This is proved by the fact that **no corporate franchise at all was necessary to receive the funds. The corporation might have discontinued all railroad operations. It might in fact have been dissolved and succeeding interests in the liquidation would have received the funds.**

To say that such mere receipt represents the exercise of the corporate franchise for railroad purposes is to render the words "railroad purposes" meaningless.

The $7,774,804.19 was property of the United States in 1933. This proposition must be regarded as a fact. The underlying factual data together with the Acts of Congress and the decision of this court in the Dayton-Goose Creek case, produced the resulting fact of ownership in the United States.

It was further a fact that this money was not distributed by the United States to defendant in 1933 as payment for transporting mails or for any activity of defendant in the exercise of its corporate franchise for railroad purposes and that it was not "derived" from the United States as a result of such exercise.

Of the moneys received by defendant, Duluth, Missabe and Northern Railway Company from the United States amounting to $7,774,804.19, the sum of $1,966,547.58 constituted accretions or earnings of funds belonging to the United States and acquired under the Act of Congress of February 28, 1920, 41 Stat. 488.

The remainder of the moneys received from the United States by the defendant amounting to $5,808,256.61, was the equivalent of the total of moneys paid by the defendant into the fund during the years 1924 to 1930 and which moneys became property of the United States prior to the time when the moneys were paid by defendant to the United States under the 1920 Act.

In the case of the so-called principal amount, namely, $5,808,256.61:

the money was originally held by defendant in trust for the United States during the years 1920 to 1930;

the moneys so held in trust for the United States during said years were transferred and paid over to the United States from time to time during the years 1924 to 1930 as set forth on page 74 Record, Volume I, Case 32125, hereinbefore in our jurisdictional statement set forth at page 24;

the money was transferred to the United States according to the Act of Congress of 1920;

defendant had no title to the money, legal or equitable. **Dayton-Goose Creek R. Co. v. U. S.,** 263 U. S. 456, 44 S. Ct. 169, 68 L. ed. 388;

defendant never received any of the money pursuant to the provisions of the Act of Congress of 1920;

the purpose of Congress was changed;

in 1933, pursuant to the Act of Congress of 1933, the money was distributed to those who had made transfers to the fund;

this distribution was made to defendant without regard to any exercise on its part of railroad ownership or operation.

To say that the accretions or earnings of the principal of such fund were derived from the exercise of defendant's franchise within the scope of railroad ownership or operation would be as superficial and baseless as saying that the bond interest in the illustration given above was derived from the exercise of the corporate franchise within the scope of railroad ownership or operation.

If the $7,774,804.19 or the $5,808,256.61 or the $1,966,547.58 received in 1933 were ordinary railroad receipts, no federal question would arise. But neither the $5,808,256.61 nor the $1,966,547.58 were receipts from the railroad business, ordinary or otherwise.

As we have seen, $1,966,547.58 of the amount paid by the United States to defendant Duluth, Missabe and Northern Railway Company was a portion of certain accretions and earnings acquired by the United States from and upon property exclusively owned by and exclusively belonging to the United States.

This money belonged to the United States. It was not income upon property belonging to defendant or to which defendant had any title, legal or equitable. The payment to defendant depended only and solely upon the Congress of the United States which by the Act of June 16, 1933, 48 Stat. 220, directed the payment. No railroad activity was necessary to condition receipt of the money by de-

fendant. It was not necessary that defendant he a railroad corporation. It was not even necessary that defendant be a corporation at all.

The corpus of the railroad contingent fund had been acquired by the United States under the 1920 Act. The accretions to the corpus, as well as the corpus itself, was distributed solely as a result of the Act of 1933. The corpus of the fund belonging to the United States was established by the Act of Congress of 1920. Accretions to it resulted from that Act. A portion of the accretions and a portion of the corpus were distributed to defendant by the Act of Congress alone.

The essential nature of the transaction resulted in income to defendant derived not from railroad ownership or operation but from the exercise of the corporate franchise without the scope of railroad ownership or operation.

The definition of non-railroad income under the Minnesota Act when applied to the funds distributed by the United States to defendant, Duluth, Missabe and Northern Railway Company in 1933 pursuant to the Act of Congress of that year, results inevitably in placing the entire $7,774,804.19 in the category of non-railroad income.

Were it not for the Acts of Congress and said decision of this court, the moneys transferred by the Duluth, Missabe and Northern Railway Company to the United States in the years 1924 to 1930 amounting to an aggregate of $5,808,256.61, would have been the company's own and would not have been income in 1933. The accretions amounting to $1,966,547.58 would not have existed. **We can only speculate on the use that might have been made by the company of the additional funds saved by non-liability for the Transportation Act payments.**

The $7,774,804.19 was an essential element of plain-

tiff's causes of action but only because of the Acts of Congress as interpreted by the United States Supreme Court. Eliminate the conditioning and determining effect of the Acts of Congress and no element of cause of action remains with respect to the sums saved in 1922 to 1929 and **the possible substitutes for the $1,966,547.58 accretions remain unknown and unpredictable.**

This, we submit, is a test of the federal question. An essential element of plaintiff's causes of action is dependent upon the Acts of Congress. Plaintiff's causes of action are as much dependent upon the federal statutes as were the causes of action in the Yates cases, **Jones National Bank v. Yates,** 36 S. Ct. 429, 240 U. S. 541, 60 L. ed. 788 and **Yates v. Jones National Bank,** 27 S. Ct. 638, 206 U. S. 158, 51 L. ed. 1002, one of which was referred to in Section A of the statement as to jurisdiction, supra. In those cases the elements of defendants' liability were controlled by and tied to an act of Congress and a federal question was held to exist.

Applying the definitions of railroad and non-railroad income fixed by the state supreme court in its interpretation of the income and franchise tax act, and applying and bearing in mind the nature of the so-called recapture fund, we find that the state supreme court has ignored the Acts of Congress of 1920 and 1933 and the decision of this court in the Dayton-Goose Creek case.

It is conceivable that the state supreme court might have found a different principle of differentiation of income, but it did not do so. Interpreting the state law as it did, it came to the conclusion as it said, 207 Minnesota, page 639, 292 Northwestern, page 412:

> "The distinction should lie between income derived from the exercise of the franchise **within** the scope of railroad ownership or operation and that from its exercise **without** such scope." (Emphasis supplied.)

It may be said that the state supreme court might have made a more inclusive definition of railroad income and a less inclusive definition of non-railroad income. The answer to this possible suggestion is: First, that it did not do so; second, that the past decisions of the court, as we have seen, tended to keep the definition of railroad income within bounds, and, third, we have a right to assume, and we do assume, that the definition and principle of differentiation adopted by the state supreme court was a considered definition and principle which would not require modification merely because of the result of its application. We have a right to assume, and we do assume, that if the state supreme court had correctly construed the facts and the Act of Congress and had correctly applied the definition, the result would have been, not to change the definition, but to place the $7,774,804.19 received from the United States in the non-railroad category.

QUESTION III

All of the voting stock of defendants is owned by and under the legally enforceable control of the same interests. Section 32 (c) of Chapter 405, Laws Minnesota 1933, provides that:

> "* * *. If 90 per cent of all the voting stock of two or more corporations is owned by or under the legally enforceable control of the same interests the Commission may impose the tax as though the combined entire taxable net income was that of one corporation except that the credit provided by Section 27 (e) shall be allowed for each corporation; but inter-company dividends shall in that event be excluded in computing taxable net income."

The Tax Commission assessed the tax separately on each corporation. It did not assess on a combined basis.

The question is whether or not the word "may" in said provision, when given its natural permissive mean-

ing, renders said provision repugnant to the equal protection clause of Section 1 of the Fourteenth Amendment, Constitution of the United States.

POINT III. Relating to taxation of affiliated corporations on a combined basis.

(1) The Supreme Court of Minnesota erred in holding that Chapter 405, Laws of Minnesota 1933, and Section 32, and especially Section 32 (c) thereof, in its permissive form as enacted by the legislature, is invalid because violative of the Fourteenth Amendment, Section 1.

(2) The Supreme Court of Minnesota erred in holding that Chapter 405, Laws of Minnesota 1933, including Section 2 thereof, and including Section 32 and subsection (c) thereof, violated the Fourteenth Amendment, Section 1, if Section 32 (c) in conjunction with the remainder of said Section 32 of said Chapter 405, were construed as permissive.

(3) The Supreme Court of Minnesota erred in holding that Chapter 405, Laws of Minnesota 1933, including Section 2 thereof, and including Section 32 and subsection (c) thereof, violated the Fourteenth Amendment, Section 1, unless Section 32 (c) in conjunction with the remainder of said Section 32 of said Chapter 405, were construed as mandatory.

(4) The Supreme Court of Minnesota erred in holding that the granting to the Minnesota Tax Commission of discretionary power to impose a tax on a combined basis pursuant to Section 32, Chapter 405, Laws of Minnesota 1933, is violative of the United States Constitution, Fourteenth Amendment, Section 1.

(5) The Supreme Court of Minnesota erred in holding that Chapter 405, Laws of Minnesota 1933, especially Section 32 (c) thereof in the form in which the legisla-

ture enacted it, imposed a penalty and not a tax and was therefore in violation of the Fourteenth Amendment, Section 1, equal protection clause.

POINT III. SUMMARY.

1. The state supreme court held that the granting by the Minnesota legislature to the State Tax Commission of discretionary power to impose a tax on affiliated corporations on a combined basis pursuant to Section 32 (c) of Chapter 405, Laws of Minnesota 1933, was violative of Section 1 of the Fourteenth Amendment of the United States Constitution.
2. The basic federal question is that Chapter 405, Laws 1933, especially Section 32 (c) thereof in the form in which it was enacted by the legislature is violative of the Fourteenth Amendment, Section 1, equal protection clause.
3. The Tax Commission in these cases levied the tax separately. The trial court sustained this holding. The state supreme court reversed the trial court.
4. The state supreme court erroneously ruled that Section 32 (c) was a penalty provision instead of an aid in determining true taxable income. This error permeates the entire decision on this branch of the cases.
5. Statutory provisions similar to Section 32 (c) are common in state and federal tax laws. Discretionary power granted to taxing authorities in accordance with such provisions have been upheld by both state and federal courts.
6. When Section 32 (c) is given its natural permissive meaning it becomes a sharper and more efficient tool in dealing with intricate corporate combinations, not for the purpose of penalizing them, but for

the purpose solely of reaching the true taxable net income of such organizations.

7. The state supreme court advanced several non-federal grounds for its decision on the points here involved. None of these grounds are adequate to support the court's decision.
8. The Minnesota constitutional provision against delegation of legislative powers (Const. Art. 3) is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature enacted it.
9. The state uniformity clause, Art. 9, Sec. 1, is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature enacted it.
10. The state uniformity clause is identical with the equal protection clause of Section 1 of the Fourteenth Amendment.
11. The statutory construction of Section 32 (c) based on Wisconsin legislative history is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature of Minnesota enacted it.
12. The statutory construction of Section 32 (c) based on the intention of the Minnesota Legislature to confer a power to be exercised for the benefit of the state or of a private party is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature enacted it.
13. The non-constitutional grounds were advanced by the court only as a necessary alternative to the natural and permissive meaning of Section 32 (c). Only under the compulsion of such necessity was the court driven to a mandatory alternative. Because of such compulsion and because of such assumed

necessity, the non-constitutional grounds cannot be treated as independent.

14. If neither the Fourteenth Amendment, Section 1, nor the state constitutional provisions are obstacles to a permissive interpretation of Section 32 (c), then there is no longer any need to seek an alternative to the natural meaning of the discretionary provision.
15. Therefore there is no need to interpret "may" as "must" in Section 32 (c).
16. The state questions in these cases are so interwoven with the federal questions as not to be independent matters.

POINT III ARGUMENT.

For the sake of brevity, we here refer to our jurisdictional statement at page 25, et seq., supra, and ask leave to incorporate the same herein.

The basic federal question on this branch of the cases is that Section 32 (c) of Chapter 405, Laws of Minnesota 1933, in the form in which it was enacted by the legislature is repugnant to the Fourteenth Amendment, Section 1, equal protection clause.

In the Appendix, page 105, et seq., we have set forth excerpts of this statute. The law imposes an income and franchise tax on individuals and corporations. The state supreme court sustained the Act against certain claims that it violated the equal protection and due process clauses of the Fourteenth Amendment and the uniformity clause of the Minnesota Constitution.[10]

In the instant cases (syllabus No. 2, 207 Minn. 618, 619, syllabus No. 3, 292 N. W. 401) the court holds the tax to

---

[10] Reed v. Bjornson, 191 Minn. 254, 253 N. W. 102, supra; Thompson-Parker Holding Company v. Bjornson, 191 Minn. 271, 253 N. W. 110, supra.

be a "property tax" upon the corporate franchise of the corporation measured by net taxable income.

The Tax Commission in all of the present five cases assessed the tax separately.[11] Defendants claim that under Section 32 (c) they together with 75 other subsidiaries of the United States Steel Corporation were entitled as a matter of right to a consolidated basis of taxation.

The trial court sustained the claim of the state and held that defendants were not entitled as a matter of right to a consolidated basis.

It was the claim of defendants (see their Answers (substituted) pages 293 et seq. and similar Answers in the other cases) that failure and refusal of the Tax Commission to tax on a consolidated basis would deny to defendants the equal protection of the laws and would deprive them of their property without due process of law contrary to the provisions of the Fourteenth Amendment to the Constitution of the United States as well as violate certain state constitutional provisions. Record, pages 289-290 in Case 32125.

For convenience we repeat here the second sentence of Section 32 (c):

> "If 90 per cent of all the voting stock of two or more corporations is owned by or under the legally enforceable control of the same interests the Commission may impose the tax as though the combined

[11]The taxes assessed for the year 1933 exclusive of interest were: Duluth, Missabe and Northern Railway Company, $569,751.99, Exhibit 2 attached to plaintiff's statement (Complaint), Record page 35, in Case 32125; The Duluth and Iron Range Railroad Company, $75,049.96, Exhibit 2 attached to plaintiff's statement, Record page 1329, in Case No. 32124; Spirit Lake Transfer Railway Company, $2,012.46, Exhibit 1 attached to plaintiff's statement, Record page 1428, in Case 32126; Oliver Iron Mining Company, $1,591.77, Exhibit 1 attached to plaintiff's statement, Record page 5 in case 32312 (Tr. 500), Proctor Water & Light Company, $1,344.48, Exhibit 2 attached to plaintiff's statement, Record page 51 in case 3231[illegible] (Tr. 1546).

entire taxable net income was that of one corporation except that the credit provided by Section 27 (e) shall be allowed for each corporation; but intercompany dividends shall in that event be excluded in computing taxable net income."

The state supreme court held that the granting of discretionary power to the Tax Commission to calculate the tax on a combined basis in accordance with Section 32 was repugnant to the Fourteenth Amendment, Section 1.

The state supreme court further held that such power was the power to impose a penalty rather than a tax. The court said, 207 Minn. 630, at page 635, 292 N. W. 407, at page 410:

"* * * It would appear that subdivisions (a) and (b) of Section 32 provide **penalties** which the legislature intended for tax evasion by corporations." (Emphasis supplied.)

Subsection (a), of course, relates to a penalty but no other provision relates to a penalty. And no party to these cases, plaintiff or defendant, ever claimed that either subsection (b) or any part of subsection (c) was a penalty.

The court further refers to "penalty" in relation to subsections (b) and (c) in the following instances on pages 635 and 636 of the decision in 207 Minnesota, and pages 410 and 411 of 292 Northwestern:

"We are convinced that the Minnesota legislature did not intend by the last sentence of subdivision (c) to impose a discretionary **penalty** on affiliated corporations in addition to the 10% penalty authorized in Section (a) against the use of corporations for splitting up income."

"Certainly we should not imply such additional **penalty** if it is one from the mere fact that subdivision (c) is associated with **penalizing** subdivisions."

"No attempt is made in subdivision (c) to define the character of any tax evasion for which the

> claimed **penalty** may be imposed by the commission, * * *."
>
> "It is significant that counsel for the state cannot suggest any concrete example of tax evasion peculiar to affiliated corporations and not described in and **penalized** by subsections (a) and (b) in imposing the combined tax upon affiliated corporations."
>
> "To us it seems clear that the legislature intended a tax always to be imposed and not a **penalty** for some undefined evasion."
>
> "Without defining the conditions which the commission must find before it could impose a **penalty** the legislature could not, as the state claims leave the imposition of the **penalty** to the discretion of the commission." (Emphasis supplied)

Thus it will be seen that the decision of the Minnesota Supreme Court is based upon its failure to distinguish between a discretionary tax of affiliated corporations upon a consolidated basis and the imposition of a discretionary penalty upon such corporations. The court was evidently of the opinion that the grant of discretionary or permissive power to a tax commission to calculate the tax upon a combined basis under the circumstances stated in Section 32 constituted the imposition of a penalty upon the corporation or corporations thus taxed.

The court failed to recognize that under the present-day complexity of intercorporate transactions, there are many possibilities of not merely wilful but also of unintentional tax evasion and that in many instances the true taxable income of corporations belonging to an affiliated group could best be determined by calculation of the tax on a combined basis.

It is clear that in a proper case taxation upon a combined basis would be a very convenient and useful method in reaching true taxable net income and at the same time avoid intricate accounting problems whose attempted solution might otherwise bring on long drawn-out litigation.

The need for the granting of such discretionary power to tax commissions for the purpose of arriving at the true taxable income of a corporation affiliated with other corporations has been recognized in the tax laws of a large number of states.

Statutory Provisions Similar to Section 32 (c) are common in state and federal tax laws.

For instance the tax law of New York, Title 59 of the New York Code, Art. 9-a, No. 211, whose heading is "Reports of Corporations to Tax Commission," second paragraph of subsection 9, is as follows:

> "The Tax Commission may permit or require the filing of a combined report where substantially all the capital stock of two or more corporations liable to report under this article is owned or controlled by the same interests. The Tax Commission may **impose the tax provided by this article as though the combined entire net income and segregated assets were those of one corporation,** but in the computation dividends received from any corporation whose assets, as distinguished from shares of stock, are included in the segregations, shall not be included in net income, **or may, in such other manner as it shall determine, equitably adjust the tax."** (Emphasis supplied)

Also No. 214 headed "Computation of Tax," subsection 7, is as follows:

> "In case any report is made as provided by Paragraphs nine, ten, or twelve of Section two hundred eleven (211) of this chapter, **the Tax Commission may assess the tax against either of the corporations whose assets or net income are involved in the report upon the basis of the combined entire net income and the combined segregated assets of the corporations,** and upon such other information as it may possess, **or may adjust the tax in such other** manner as it shall determine to be equitable." (Emphasis supplied)

Thus the State of New York has granted its tax commission the discretionary power either to tax affiliated corporations upon a combined basis or else to adjust the tax in such other manner as it chooses.

These provisions of the New York law were discussed by the New York Court of Appeals in the case of **People ex rel Studebaker Corporation of America v. Gilchrist,** 244 N. Y. 114, 155 N. E. 68.

In an opinion by Justice Cardozo, the court said, page 71:

> "If the first and third paragraphs do not sustain the tax, there can be little basis for argument that the second paragraph applies. That paragraph assumes the existence of two corporations, both owned by like interests and both subject to taxation. It assumes that the two shall join in a single or combined report, **and the tax then laid upon the two, or divided between them according to some equitable adjustment."** (Emphasis supplied)

It will be noted that in this opinion Justice Cardozo nowhere questions the validity of the discretionary combined basis if the taxpayer in question is subject to the state jurisdiction. However, it was decided in that case that the defendant was a foreign corporation not within the jurisdiction of the state.

The dissenting opinion of Justice Crane at pages 73-74 quoted in the following note further bears out the fact that the validity of such discretionary combined basis was not questioned.[12]

12"This case, in my judgment, comes within sub-division 9 of Section 211 of the Tax Law, and subdivision 7 of Section 214. * * * A method specifically provided for corporations coming within these subdivisions is not improperly or illegally used to ascertain net profits under such conditions as here exist, although the condition may not be specifically stated in the statute. The commission had a duty to discharge and that was to ascertain what would have been the net profit under a fair agreement with the holding or parent company. In the absence of other means of ascertainment or of other informa-

Judge Learned Hand in the case of **Procter & Gamble Co. v. Newton,** 289 Fed. 1013, in the Fed. District Court for the Southern District of New York referred to Section 211, Subdivision 9 of Article 9-A of the New York Tax Law (consolidated laws Chapter 60) as amended by Laws 1920, Chapter 640, Section 3, and amended by Laws 1922, Chapter 507, Section 1. Section 211 provided for consolidated reports of affiliated corporations. The question was whether or not Section 211 extended the scope of Section 209 to cover the plaintiff parent corporation which was alleged not to be doing business in the state.

However, the court in the following quotations recognized the validity of discretionary taxation of affiliated corporations on a combined basis. The court said in regard to the New York Law, page 1014:

> "It **does direct** such corporations to file a 'consolidated report' of the 'combined net income,' but it **only authorizes** the commission to impose the tax provided by this article as though the entire net income and segregated assets were those of one corporation." (Emphasis supplied)

And at page 1015:

> "Subdivision 9 of Section 211 was designed, I should suppose, merely to allow the commission to estimate the income of a subsidiary in the case therein provided by **another standard.** That would be a proper enough course since the subsidiary's privilege of doing business within the state is always conditional on such terms as it chooses to impose." (Emphasis supplied)

---

tion furnished by the relator, it was justified in adopting the figures which were given and arriving at the net profits according to the methods used in other or similar cases. If the parent company had been doing business directly in New York state, there is no question about the correctness of the methods adopted by the Tax Commission."

The tax laws of California contain a similar provision. The first paragraph of sec. 14, Chapter 836, Laws 1937 of the State of California is as follows:

> "In case of two or more corporations, or one or more corporations owned or controlled directly or indirectly by the same interests, the commission may permit or require the filing of a combined report and such other information as he deems necessary, and **is authorized to impose the tax due under this act as though the combined entire net income was that of one corporation,** or **to distribute, apportion, or allocate the gross income or deductions between or among such corporations,** if he determines that such consolidation, distribution, apportionment or allocation is necessary **in order to prevent evasion of taxes or clearly to reflect the income of any such corporation."** (Emphasis supplied)

Thus California likewise has recognized the desirability of granting discretionary power in the matter of taxing affiliated corporations upon a combined basis for the purpose of preventing tax evasion and as a means of more clearly arriving at the income of the individual members of the affiliated group.

The Tax Law of Oregon, Oregon Code 1930, Chapter 69, Section 1325, contains the following:

> "Where the tax commission has reason to believe that the true income is not reflected in a return made by a corporation which is affiliated with another or other corporations, within the meaning of this section, it may require separate or consolidated returns from said corporations and apply the tax upon the next (net) income determined therefrom. * * * The corporations which may be joined in a consolidated return shall, for the purpose of this act, be treated as one taxpayer and taxable only upon their consolidated profits properly attributable to the state of Oregon."

Similar provisions are found in the corporation income tax statutes of a number of other states, among which

are Iowa,[13] Montana,[14] North Dakota,[15] South Dakota.[16]

The Congress of the United States has also deemed it advisable to grant discretionary power to the Commissioner of Internal Revenue in the matter of the consolidation of accounts and returns of affiliated corporations.

The Federal Revenue Act of 1926, Section 240, Chapter 27, 44 Stat. 46, Act of February 26, 1926, contains discretionary provisions for consolidation of accounts of related trades and businesses.[17]

The Federal Revenue Act of 1924, Section 240, Chapter 234, 43 Stat. 288, Act of June 2, 1924, contained the same provision.

The discretion of the commissioner in refusing to permit the consolidation of accounts when requested to do so by the taxpayer was challenged in the Federal Courts upon a number of occasions and was sustained in every case.

In the case of **Ellison v. Commissioner of Internal Revenue,** 76 F. (2d) 509, (C. C. A. 2nd) (1935), the court said at page 510:

> "By its express terms this section serves no purpose except when action under it is "necessary in order to make an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses." Whether that is necessary is primarily for the determination of the Commissioner whether he acts

---

13Code of Iowa 1939, section 6943.069.

14Revised Code of Montana 1935, section 2303.1.

15Chapter 283, North Dakota 1931 Session Laws.

16Code of South Dakota 1939, section 57.2714.

17"(d) In any case of two or more related trades or businesses (whether incorporated or unincorporated and whether organized in the United States or not) owned or controlled directly or indirectly by the same interests, the commissioner may and at the request of the taxpayer shall, if necessary in order to make an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses, consolidate the accounts of such related trades or businesses."

> sua sponte or is requested to act by a taxpayer. If the commissioner fails to find necessity for action and so refuses a taxpayer's request, his determination is final unless shown to have been arbitrary and contrary to the evidence. See Nowland Realty Co. v. Commissioner (C. C. A.) 47 F. (2d), 1018. It is on a par with other findings of fact."

Other cases sustaining the discretion of the commissioner in respect to the consolidation of accounts are:

Crossett Western Co. v. Commissioner of Internal Revenue, 73 F. (2d) 307;

Nowland Realty Co. v. Commissioner, 47 F. (2d) 1018 (C. C. A. 7th) (1931);

Remco SS. Co. v. Commissioner, 82 F. (2d) 988 (C. C. A. 9th) (1936), Certiorari denied 57 S. Ct. 17, 299 U. S. 55, 81 L. ed. 409.

The above subsection (d) became section 45 of Chapter 852, Act of Congress, May 29, 1928, 45 Stat. 806 when it was amended to read as follows:

> "Allocation of Income and Deductions.—In any case of two or more trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such trades or businesses if he determines that such distribution, apportionment, or allocation is necessary **in order to prevent evasion of taxes or clearly to reflect the income of** any of such trades or businesses." (Emphasis supplied)

This provision has been retained as section 45 in every revenue act enacted since 1932.

Under the Federal Revenue Act of 1926, and under other federal revenue acts, discretion was also given to the Commissioner of Internal Revenue in the filing of separate or consolidated returns. Provision was made

that once a corporation had made an election to make return on separate or consolidated basis, the basis for subsequent years might not thereafter be changed without permission granted by the commissioner.

With reference to this provision, the court said in the case of **Lucas, Commissioner of Internal Revenue v. St. Louis National Baseball Club,** 42 F. 2d, 984 (C. C. A. 8th) Decided July 19, 1930, rehearing denied August 23, 1930, certiorari denied 51 S. Ct. 87, 282 U. S. 883, 75 L. ed. 779:

> "No permission to file this consolidated return had been obtained from the Commissioner of Internal Revenue. The Commissioner rejected the consolidated return for the year 1923, on the ground that both corporations had filed separate returns for the year 1922 and had obtained no permission from the Commissioner to make a change."

The discretion of the commissioner of Internal Revenue in this respect was also sustained in the following cases:

Dr. Pepper Bottling Company v. Commissioner of Internal Revenue, 69 F. (2d) 768;

Export Leaf Tobacco v. Commissioner of Internal Revenue, 78 F. (2d) 163, Certiorari denied 56 S. Ct. 150; 296 U. S. 627.

T. C. Williams Company v. Commissioner of Internal Revenue, 78 F. (2d) 163, Certiorari denied 56 S. Ct. 150; 296 U. S. 627.

Smith Paper Company v. Commissioner of Internal Revenue, 78 F. (2d) 163, Certiorari denied 56 S. Ct. 150. 296 U. S. 627.

In the 1932 Revenue act corporations wishing to avail themselves of the privilege of filing consolidated returns were compelled to pay an additional three-fourths of one per cent tax upon their incomes. In the 1934 Act, this privilege was restricted to railroads and railroad holding companies. In 1938 this privilege was extended

to include street and interurban railway operating and holding companies but was denied to other corporations. This provision was retained in the 1939 Revenue Act. However, as to those corporations still having this privilege, the discretionary power of the Commissioner to grant or refuse permission to change the basis of return from an individual to consolidated and vice versa has been retained in every Revenue Act to date.

Thus both the Federal and State governments have recognized the propriety of granting discretionary power to administrative tax authorities in the matter of the consolidation of accounts and returns of affiliated corporations and their taxation upon a combined basis. In no case has any income tax statute declared, nor has any court construing such a statute ever ruled, that the exercise of discretion by a taxing authority with reference to taxing affiliated corporations on a consolidated basis, or granting permission to consolidate accounts or returns, constituted a penalty.

In this connection it should be kept in mind that the taxation of affiliated corporations by the states is rendered difficult because of the interstate character of many of the corporate transactions. This is a problem which the United States government does not have to contend with except in the case of corporations having international transactions. A discretionary power granted to state tax commissions may well be the most effective means of preventing tax evasion and arriving most accurately at the true income of the affiliated groups of corporations within the taxing state.

We therefore, submit to this court, that the natural permissive interpretation of the word "may" in the second sentence of section 32 (c) of the Minnesota Income Tax Act which would grant the Minnesota Tax Commission discretionary power in the matter of taxing

affiliated corporations upon a consolidated basis, **does not make this section repugnant to the equal protection clause of Section 1 of the Fourteenth Amendment** to the United States Constitution.

The non-federal grounds in these cases are neither adequate nor independent.

1. **The State constitutional questions.** In considering the question of whether or not there is any adequate independent non-federal ground for striking down Section 32 (c) in its permissive form, let us first determine if there is any independent state constitutional ground.

In the decision in the Oliver and Proctor cases, 207 Minn. 630, at page 636, 292 N. W. 407, at pages 410, 411, the court said:

> "Without defining the conditions which the commission must find before it could impose a penalty, the legislature could not, as the state claims, leave the imposition of the penalty to the discretion of the commission. There would be an unconstitutional delegation of legislative powers. A. L. A. Schechter Poultry Corp. v. United States, 295 U. S. 495, 55 S. Ct. 837, 79 L. ed. 1570, 97 A. L. R. 947. There would also be a lack of uniformity which would violate our constitutional requirements (Minn. Const., art. 9, sec. 1, as well as U. S. Const., Amend. XIV) if discrimination resulted. We therefore give the statute an interpretation in harmony with the constitution."

No reason is given by the court for any claim of unconstitutionality under the state constitution except as quoted above. The court's syllabus (No. 3 at page 630) states:

> "It would be an unconstitutional delegation of legislative power to authorize the tax commission in its discretion to impose a penalty without a legislative definition of the conditions which it must find to exist before such penalty could be assessed. And if the imposition of the penalty be left to the uncontrolled discretion of the commission and resulted in

discrimination, it would be a violation of our constitutional uniformity clause and of the XIVth amendment."

The court quoted only one case, **A. L. A. Schechter Poultry Corporation v. United States, supra.** To the state supreme court in the instant cases Section 32 (c) was not a taxing provision but a penalty similar to the penalizing regulation of the N. I. R. A. involved in the Schechter case.

The basic error of the state supreme court on this branch of the case is in holding that Section 32 (c) in the form in which the legislature enacted it imposes a penalty and not a tax and that it is therefore in violation of the Fourteenth Amendment, Section 1. This error manifests itself in various ways but, however stated, the same basic misconception is at the bottom of the court's reasoning.

The same reason, namely, that the discretionary calculation of the tax on affiliated corporations upon a consolidated basis amounts to a discretionary penalty, is the basis of all the court's constitutional objections, state as well as federal.

The same reason is at the basis of the court's statutory interpretation causing it to give an unnatural meaning to the permissive "may" in the disputed sentence as hereinafter pointed out. As we have shown the discretionary use of the combined basis does not penalize but merely serves to enable the Tax Commission to more accurately determine the true taxable income of the corporation in a proper case. Therefore the rationale by which the court arrives at the conclusion that there would be violation of the Fourteenth Amendment, Section 1, if the word "may" be given its natural meaning, fails of support.

This is the same line of reasoning used by the court for the claim that such an interpretation of the word

"may" would be violative of the uniformity clause of the state constitution. It is also the same reasoning assigned for the claim that such an interpretation would violate the state constitutional provision against delegation of legislative powers. Thus the rationale for these state constitutional objections also fail of support.

In this connection we call attention to the fact that the state uniformity clause, Article 9, Section 1 of the Minnesota Constitution, has in a number of cases been held to be identical in scope with the equal protection clause of Section 1 of the Fourteenth Amendment. In **National Tea Company v. Minnesota,** 205 Minn. 433, 286 N. W. 360, the Minnesota Supreme Court discussed not only the equal protection clause of the Fourteenth Amendment but also the uniformity clause which provides "taxes shall be uniform upon the same class of subjects. * * *" The Minnesota court cited **Reed v. Bjornson,** 191 Minn. 254, 253 N. W. 102. In the latter case, 191 Minnesota, at pages 260-261, 253 Northwestern, at page 105, the Minnesota court said:

> "In Lake Superior C. I. Mines v. Lord, 271 U. S. 577, 581, 46 S. Ct. 627, 628, 70 L. ed. 1093, 1101, a tax case, the Supreme Court, construing our constitutional requirement of uniformity, said that "it seems to us sufficiently plain that this provision goes no further than the fourteenth amendment. Consequently, if the legislation under review does not offend that amendment there is no conflict with the state constitution." Of course the proper construction to be given our constitution is not a federal question but one upon which our own views are controlling. Nevertheless we regard the construction thus placed upon it by that high court as entitled to great weight."

This court in **Minnesota v. National Tea Company,** 60 S. Ct. 676, at page 677, 309 U. S. 551, (March 25, 1940), referred to the fact that in **National Tea Co. v. Minnesota, supra,** the Minnesota court said:

> "These provisions of the Federal and State Constitutions imposed identical restrictions upon the legislative power of the state in respect to classification for purposes of taxation."

According to the Minnesota court, the natural permissive interpretation of the word "may" is violative of the Fourteenth Amendment because in its permissive form it provides for the imposition of a penalty without defining the conditions which the commission must find before it could impose a penalty. Therefore, says the court, it is a violation of the "uniformity clause" of the state constitution. Therefore, says the court, it is also an unconstitutional delegation of legislative power.

However, if the natural permissive interpretation of the word "may" does not amount to a grant of power to impose a discretionary penalty, this provision is not violative of the Fourteenth Amendment. Therefore, it is not violative of the "uniformity clause" of the state constitution. Therefore also, it is not an unconstitutional delegation of legislative power.

Thus the rationale for all the constitutional objections, state as well as federal, breaks down when once it is determined that the natural permissive interpretation of the word "may" is not a grant of discretionary power to impose a penalty.

We, therefore, submit that the state constitutional grounds for the decisions of the Minnesota Supreme Court are so interwoven with the federal constitutional ground that they cannot be considered adequate independent grounds for the decisions of the Minnesota court.

2. **Questions of Statutory Construction.** We have noted that the court said "we therefore give the statute an interpretation in harmony with the constitution," 207 Minnesota at page 636, 292 Northwestern at page 411. It is a rule of Minnesota statutory construction that

"if the language of a law is reasonably susceptible of two constructions, one of which will render it unconstitutional and the other not, the former must be adopted though the latter is the **more natural.**" **Dunnell's Minnesota Digest,** Section 8931, citing **State ex rel Decker v. Montague,** 195 Minn. 278, 286, 262 N. W. 684, 688, in which the Minnesota Supreme Court stated the above rule as follows:

> "Under the familiar rule stated in 6 Dunnell, Minn. Dig. (2 ed. and Supps. 1932, 1934) section 8931: 'If the language of a law is reasonably susceptible of two constructions, one of which will render it constitutional and the other not, the former must be adopted though the latter is the **more natural.**'" (Emphasis supplied)

It is further a rule of Minnesota statutory construction that "a statute will not be construed so as to render it unconstitutional unless there is **no reasonable alternative.**" **Dunnell's Minnesota Digest,** Section 8950. (Emphasis supplied)

In support of this statement of the law, the author cites the case of **Johnson Service Company v. Kruse,** 121 Minn. 28, 140 N. W. 118, where the court said at pages 32-33:

> "But the statute cannot properly be given this construction, for such would violate the rule that a statute will not be construed in such a manner as to render it unconstitutional except when there is **no other alternative.**" (Emphasis supplied)

We may, therefore, conclude that the non-constitutional grounds given by the court for its decision are intended as a necessary alternative to an otherwise unconstitutional interpretation of the word "may" in Section 32 (c). Clearly the permissive meaning is a natural one. Only under the compulsion of necessity has the court been driven to a mandatory alternative.

If neither the Fourteenth Amendment, Section 1, nor the state constitutional provisions are obstacles to a permissive interpretation of Section 32 (c), then there is no longer any need to seek an alternative to the natural meaning of the discretionary provision.

Thus the non-constitutional grounds given for the opinion of the court in this case cannot be treated as independent grounds, because they are given as the alternative to an otherwise unconstitutional interpretation of the statute. For, no matter how persuasive or cogent the reasons given by the court for them, it is possible that the court might give even more persuasive and cogent reasons for a natural interpretation of the statute, if it were not deterred therefrom by the fear of unconstitutionality.

With respect to the adequacy and substantiality of the non-constitutional grounds advanced by the court an analysis of the court's opinion shows that the first ground mentioned relates to the alleged Wisconsin history of the Minnesota Act. In 207 Minnesota at page 634, 292 Northwestern at page 410, the court says:

> "It seems obvious that with that litigation in mind the Minnesota legislature attached the last sentence of subd. (c) for the purpose of making the powers and duties of the Minnesota tax commission clear; **that it sought to give the Minnesota commission the power the Wisconsin commission claimed.**" (Emphasis supplied)

We agree with the Minnesota Supreme Court that the Minnesota legislature sought to give the Minnesota Tax Commission the powers that "the Wisconsin Commission claimed." However, it is clear that the Wisconsin Tax Commission never contended for a restriction of its powers. On the contrary it contended for expansion of its powers. What the Wisconsin Commission claimed was discretionary power to tax affiliated corporations

upon a consolidated basis in cases where the facts were similar to those in the Curtis case. **Curtis Company v. Wisconsin Tax Commission,** 214 Wis. 85, 251 N. W. 497, 92 A. L. R. 1065. A careful study of the Wisconsin cases cited by the Minnesota court in its decision makes this very clear.

The second non-constitutional ground given by the court for its decision is contained in the following excerpt from the opinion, 207 Minnesota at page 636, 292 Northwestern at page 410:

> "Moreover where a power is conferred to be exercised for the benefit of the state or a private party the word "may" is to be construed to mean "must" and the statute is mandatory."

The opinion does not state for whose benefit the power was given, whether for the state or for a private party. Nowhere does the court state that the alleged benefit is for a private party. The only alleged benefit pointed out by the court for the state is in the statement that taxation on a combined basis "is normally in the interest of the state," 207 Minnesota at page 635, 292 Northwestern at page 410. The court follows the statement just quoted with a sentence:

> "Where graduated surtaxes are imposed, any other construction of the act would be unfair to the state as permitting what is actually one taxpayer to be divided into several so that a lower rate would be applicable."

The graduated surtaxes imposed upon corporations under Chapter 405 amounted to a maximum of $250 in any one case. Even this small graduated feature of the corporation tax was repealed by the legislature in 1937, Chapter 49, Extra Session Laws Minnesota 1937. This graduated feature was a trifling element in the rate structure. How trifling was the graduated feature of the corporation tax may be shown by the following illustra-

tions. Section 6, of Chapter 405, provides for a graduation in the rate of taxes from 1% for the first $1,000 of taxable income to 5% on all income in excess of $10,000. Under this provision a corporation might save anywhere from nothing to a maximum of $250 by reason of being taxed upon a graduated basis instead of upon a flat rate of 5% on all its taxable income. The effect of this provision standing alone would therefore increase a tax to be paid by an affiliated group of corporations by a sum ranging up to $250 for each member but one of the affiliated group.

Statistics compiled by the United States Treasury Department based upon corporate income tax returns for the years 1909 to 1937[18] show that during this period more than one-half of all corporation income tax returns reported either deficits or no incomes. For the period 1930 to 1937, inclusive, the number of corporation returns reporting either deficits or no income was almost twice, as great as those reporting taxable income.

When taxed upon a combined basis all deficits incurred by members of an affiliated group are offset against the taxable income earned by other members of the group. Consequently, there is every likelihood that deficits incurred by some members of the group would make up for any increase in the tax of the group by reason of the graduated feature of the statute. In the cases here involved under the judgments of the state court as they

---

[18]Statistics of income for 1937, part 2. Compiled from corporate income and excess profits returns and personal holding company returns. United States Treasury Department, Bureau of Internal Revenue. When added together the total of corporation returns reporting net income for the period of 1909 to 1937 inclusive is 5,287,059. The total of corporation returns reporting no net income for the same period is 5,985,580. The total of corporation returns reporting net income for the period 1930 to 1937 inclusive is 1,294,271 and the total of corporation returns reporting no net income for the same period is 2,433,807.

now stand, 75 corporations claimed deficits or no incomes and of the remaining five, three denied liability.

Furthermore, Section 32 (c) of the Minnesota Act provides for the exclusion of inter-company dividends from the computation of the taxes of affiliated groups upon a combined basis, as well as for the retention of the individual credit of each member of the group which under the statute amounts to $1000 per corporation. This means that in the exceptional case where all members of the affiliated group are earning a profit so that there is no deficit to offset against taxable income, the state would "normally" still lose revenue when the group is taxed upon a combined basis as compared with calculation on an individual basis by reason of the exclusion of inter-company dividends from the computation of the tax.

For illustration let us take an affiliated group composed of 10 corporations, each of which has earned taxable income in excess of $10,000 exclusive of intercorporate dividends. In such case by reason of the graduated provision standing alone the affiliated group would have its taxes increased by $2250 as compared with taxation on an individual basis, for only one graduation of the corporate income tax would be allowed under the law. However, this would be offset if there were inter-company dividends amounting to $45,000. In such case the saving in taxation in the case of the affiliated group would also equal $2250. If the inter-company dividends amounted to more than $45,000 as would not be unlikely in the case of an affiliated group having a taxable income of $100,000 or more, the affiliated group of corporations would pay less taxes upon a combined basis than upon an individual basis. Therefore it seems reasonable to conclude that it would be a very unusual case where an affiliated group of corporations would pay more taxes

upon a combined basis than upon an individual basis.

No element so trifling and unsubstantial as the graduated feature of the corporation tax could form the basis of the benefit to the state referred to in the court's decision.

We respectfully submit that it is only when Section 32 (c) is given its natural permissive meaning that the provision makes sense. In such case it becomes a sharper and more efficient tool in dealing with intricate corporate combinations, not for the purpose of penalizing them, but for the purpose solely of reaching the true taxable net income of such organizations.

For the sake of brevity we here refer to our jurisdictional statement at page 25, et seq., supra, and ask leave to incorporate the same herein.

Therefore, we respectfully submit that the second sentence of Section 32 (c) which provides for the granting of discretionary power to tax affiliated corporations upon a combined basis, does not violate the equal protection clause of Section 1 of the Fourteenth Amendment.

QUESTION IV

The question is whether or not Section 12, Chapter 405, Laws of Minnesota 1933, which provides for the inclusion of income from federal securities together with income from all other securities, with the sole exception of income from Minnesota state and local securities, in the measure of the Minnesota Corporate Franchise Tax, is repugnant to the immunity of federal securities from state taxation under the Constitution of the United States.

POINT IV.

Relating to inclusion of interest from federal securities in the measure of the Minnesota Corporate Franchise Tax.

The Supreme Court of Minnesota erred in holding that the plaintiff, in its causes of action against defendants Duluth, Missabe and Northern Railway Company and The Duluth and Iron Range Railroad Company, was not entitled to include in their gross income, interest from federal securities.

The Supreme Court of Minnesota erred in holding that the inclusion of income from federal securities in the measure of the Minnesota Corporate Franchise Tax, under Section 12 of Chapter 405, Laws Minnesota, 1933, is repugnant to the immunity of federal securities from state taxation under the Constitution of the United States.

POINT IV. SUMMARY

(1) The United States Supreme Court decisions relied upon by the Minnesota court do not support its holding that the inclusion of income from federal securities in the measure of the Minnesota Corporate Franchise tax constitutes "unfriendly discrimination" against United States securities in favor of local securities in "substantial competition" with federal securities.

(2) The Minnesota statute Section 12, places income from federal securities in the same class as income from all other securities, in regard to inclusion in the measure of its corporate franchise tax, with the sole exception of Minnesota state and local obligations.

(3) Statutes giving preferment to state over federal securities in the matter of their inclusion in measures of franchise taxation have been construed as valid in other states.

(4) New York State now has a statute in force giving certain of its bonds a much greater preferment in the field of corporate franchise taxation, than would be their mere exclusion from the measure of such a tax.

(5) Laws of this character have not interfered with the marketing of federal securities in the important state of New York or elsewhere in the United States.

(6) Congress itself has enacted legislation resulting in giving a preferment to state securities over federal securities by making federal securities subject to surtax and excess profits taxation by the United States.

(7) The granting of some additional inducement to investors in the way of tax preferment is justifiable in the case of state and local securities since they are less attractive to purchasers than federal securities.

(8) The Minnesota Corporate Franchise Tax exempts institutional investors which are the most important class of corporate purchasers of both state and Federal securities.

(9) Minnesota has evidenced no hostile intent against the United States government in excluding its own securities from the measure of its corporate franchise tax.

(10) In the cases now before this court, there is no evidence whatsoever that the securities of the State of Minnesota and its local subdivisions are in "substantial competition" with the securities of the federal government.

(11) The United States Supreme Court has held in analogous situations affecting interstate commerce that such matters were properly within the province of the legislative function of the United States government.

POINT IV. ARGUMENT

Whether or not the statute Chapter 405, Section 12 of the Minnesota Corporate Franchise tax, because of its exclusion of income from state and local securities, violates the immunity from taxation of federal securities under the United States Constitution by reason of its inclusion of income from federal securities in the measure of the Minnesota Corporate Franchise Tax.

The Minnesota Supreme Court said in its opinion in the case of **Duluth, Missabe & Northern Railway Co., et al.,** 207 Minn. 618, 626, 7, 292 N. W. 401, 406:

> "* * * the inclusion of income from tax exempt securities as a measure of the tax is objectionable when it evidences an attempt to discriminate against income from a particular source. Miller v. Milwaukee, 272 U. S. 713, 47 S. Ct. 280, 71 L. ed. 487; Schuylkill Trust Co. v. Pennsylvania, 296 U. S. 113, 56 S. Ct. 31, 80 L. ed. 91. The dissent in the latter case said that the discrimination must be either unfriendly in design, or in favor of securities in competition with federal securities included in the tax. It seems, in the instant case, that to allow taxation of federal government securities under subd. (g), would operate not only as a discrimination, but also as an unfriendly one, to the favor of local securities which are in fact in substantial competition with the federal securities. We, therefore, conclude that under any interpretation of subd. (g) income from federal securities should not be included in the measure of the tax on defendant's non-railroad income imposed by c. 405."

An analysis of the cases cited in this opinion shows that neither the Miller case nor the majority or the dissenting opinions in the Schuylkill case bear out this broad conclusion of the court.

The case of **Miller v. Milwaukee, supra,** involved a tax upon corporation dividends in proportion to the percentage of the income of the dividend paying corporation which had escaped taxation under the Wisconsin corporation income tax.

In this case Justice Holmes who wrote the majority opinion, said, at page 715:

> "If the avowed purpose or self-evident operation of a statute is to follow the bonds of the United States and to make up for its inability to reach them directly by indirectly achieving the same result, the statute must fail even if but for its purpose or special operation it would be perfectly good. Under the laws of Wisconsin the income from the United States Bonds may not be the only item exempted from the income tax on corporations, but it certainly is the **most conspicuous instance** of exemption at the present time. * * * A tax very well may be upheld as against any casual effect it may have upon the bonds of the United States when passed with a different intent and not **aimed** at them, but it becomes a more serious attack upon their immunity when they are its **obvious aim.**" (Emphasis supplied.)

Justice Holmes' objection to the tax was that it was **aimed principally** at United States securities. The objection was not that any **particular source of income** used to measure the tax was included, (even though that source were interest on United States securities) but simply that the bonds of the United States government were the **principal source** of the income used to measure the tax. There is nothing in this decision which can lend any support to a conclusion that income from federal obligations may not be included in the measure of a tax which also includes income from all other securities with the **sole exception** of income from state securities.

The Schuylkill case cited supra involved a Pennsylvania statute taxing shares of trust companies which excluded from its measure the value of shares of corporations either already taxed or specifically exempted from taxation under the provisions of the Pennsylvania capital stock tax statute.

The objection of the majority of the court to the validity of the tax on trust company shares was that the

sole test used for exclusion from the measure of the tax, depended upon the tax status of the exempted securities under another taxing statute. For this reason it appeared to the majority of the court that Pennsylvania was aiming at the immunity of Federal Securities from taxation rather than attempting to make justifiable exclusions from the measure of the tax. In this case, 296 U. S. 113, the court said at page 120:

> "If the tax is lifted from the shares of certain trust companies because those companies own only **stocks already taxed or relieved from taxation by the state,** and shares in other trust companies are taxed amongst whose assets there are United States bonds or other securities entitled to exemption because issued by federal instrumentalities which are figured in the base of the tax, it is impossible to avoid the conclusion that the law discriminates in favor of the former against the latter solely by reason of ownership of such federal securities," (Emphasis supplied.)

The majority opinion of the court in this case is therefore no authority for any conclusion as to the invalidity of a taxing statute where the basis of the exclusion of any security from its measure is other than that it is being taxed or exempted from taxation under any other taxing statute. The language used in this decision does not apply to a case where the exclusion is based upon the **ordinary** public policy of a state in exempting its own securities from taxation without any hostile intent against federal securities.

Nor does the dissenting opinion in the Schuylkill case support the Minnesota court in its conclusion. In his dissent at page 128, Justice Cardozo said:

> "Unfriendly discrimination might be inferred if securities of every kind were excluded from the reckoning with the single exception of the obligations of the national government. That would be an extreme case, the conclusion hardly doubtful. Even though hostility were not so pointed as in the case

> supposed, there might still be an invidious distinction if securities in substantial competition evidences of indebtedness issued by the National Government had been given a preferred position. Nothing of the kind appears."

A comparison of the foregoing excerpt from Justice Cardozo's opinion with the opinion of the Minnesota court indicates that the Minnesota court used much the same language in its characterization of the inclusion of federal securities and the exclusion of state securities in the measure of its corporate franchise tax.

However, Justice Cardozo and the Minnesota court differ widely as to the kind of situations to which such language applies. This is demonstrated when, for the purpose of proving that there was no "unfriendly discrimination" in the Schuylkill case, Justice Cardozo continuing with his dissent said at page 129:

> "The situation, there is this: Vast classes of securities, bonds and notes of every kind, as well as shares of stock in many and varied enterprises, are in the same position for the purpose of the tax in suit as government bonds and notes. The few investments that occupy a different position are not comparable in kind or in attractiveness to the obligations of the government, and do not substantially compete with them."

This is the same situation as exists in reference to the Minnesota statute. The only investment that is excluded from the measure of the tax is interest from obligations of the State of Minnesota and its subdivisions. Income from all other securities is included.

What Justice Cardozo meant by "unfriendly discrimination" and "substantial competition" can best be ascertained from the following excerpt from his dissent in which he used as analogy the taxation of national banks, pages 129, 130, 131:

> "The discrimination, as has been said, must be so marked as to justify the inference that it was un-

> friendly in design or at the very least it must favor forms of investment that are in substantial competition with government securities. A helpful analogy is found in the taxation of national banks. * * * Adams v. Nashville, 95 U. S. 19, at page 22, 24 L. ed. 369, 22 Am. Rep. 430, was a case where a municipal ordinance gave exemption from taxation to the municipal bonds. Again the ruling was that this exemption of particular property did not affect the validity of the tax upon the shares. The plain intention of that statute (R. S. §5219 was to protect the corporations formed under its authority from unfriendly discrimination by the states in the exercise of their taxing power." "It was not intended to cut off the power to exempt particular kinds of property if the legislature chose to do so." Id. Mercantile Nat. Bank v. New York, 121 U. S. 138, 30 L. ed 895, 7 S. Ct. 826, was a case where exemption had been given to bonds of municipal corporations and also to deposits in savings banks. Again the protest of discrimination was unavailing to defeat the tax."

Therefore, it is evident that none of the cases cited by the Minnesota court give support to its conclusion that the exclusion of income from obligations of the State of Minnesota and its subdivisions from the measure of the corporation franchise tax is an unfriendly discrimination in favor of local securities which are in substantial competition with federal securities included in the tax.

In regard to the specific question as to the validity of a taxing statute which excludes from the measure of a state franchise tax on corporations state obligations or their income but gives no such exclusion to federal obligations or their income, we have found no federal cases in point. There are, however, a number of state statutes and decisions which are of interest in this connection.

The question of discrimination against the United States by reason of such an exclusion of state obligations from the measure of a tax on national banks was under consideration in 1916 by the South Carolina Su-

preme Court in the case of **Nat. Union Bank of Rock Hill v. Neil,** 106 S. Ct. 173, 182, 90 S. E. 744.

The court said in reference to this matter at page 182:

> "The exemption of State bonds in ascertaining the value of shares in the hands of shareholders of the banks is **not an unlawful discrimination,** either against Federal securities or other state and municipal bonds not so exempted. Chester v. White, 70 S. Car. 433, 50 S. E. 28; Mercantile Bank v. New York, 121 U. S. 138, 7 S. Ct. 826, 30 L. ed. 895." (Emphasis supplied.)

A similar statute of the State of Oklahoma exempting public building bonds of that state from the measure of the tax on national banks was construed in 1924 by the Oklahoma Supreme Court in the case of **In re Assessment of Walters National Bank of Walters,** 100 Okla. 155, 160, 228 P. 953. The court said at page 160:

> "It is therefore concluded that the assessed valuation of the shares of stock in the instant case should have been upon the actual values thereof, less the amount of public building bonds in which the capital of the bank was invested and that in denying the claimed deductions the trial court erred."

Thus the Oklahoma court recognized the validity of an exemption of public building bonds of the State of Oklahoma in a statute taxing national bank shares which gave no such exemption to federal securities.

This position of the Oklahoma court was reaffirmed by it in **Board of Equalization v. Exchange Nat. Bank,** 104 Okla. 92, 230 P. 728.[19]

With reference to the exclusion of income from state obligations from the measure of a corporate franchise tax, which at the same time does not exempt income from federal obligations, there is a noteworthy decision

---

[19]The South Carolina and Oklahoma cases here discussed are cited in the annotation to the case of Schuylkill v. Pennsylvania, 81 L. ed. 91, at page 105.

by the New York Court of Appeals construing a New York statute.

In 1917, the legislature of New York State enacted a franchise tax on the ordinary business corporation measured by net income. In the computation of net income, "gross income" from which net income was defined in the statute as being the same as reported to the United States government by the taxpaying corporation. Under the federal law at that time gross income excluded all income from state and local governmental obligations but included income from obligations of the United States government to the extent that they were not exempt from "war profits" taxation in the hands of the taxpayer.

Construed literally, the effect of this provision of the New York law was that in case of those corporations subject to "war profits" taxation, income from these federal obligations was included in the measure of their New York corporation franchise tax, although income from the obligations not only of the State of New York and its subdivisions but also of all other states of the Union and their subdivisions was exempted from the measure of this tax.

The question of the proper construction of this statute was determined by the New York Court of Appeals in the case of **People ex rel Standard Oil Co. of New York v. Law, et al., State Tax Commission,** 142 N. E. 44, 237 N. Y. 142, 143.

In the syllabus of this decision at page 142 is contained the following pronouncement:

> "2. Interest on United States bonds should be included in estimating gross income unless they come within subdivision 4 of section 213b of the federal statutes.
>
> 3. Interest received on tax exempt bonds of the state of New York and political subdivisions thereof

> forms no part of gross income and should not be considered."

The Court said in its opinion at pages 149, 150:

> "If this is so the result reached below is not wholly correct. As there was included in gross income interest on bonds of the United States and also on bonds of New York and various political subdivisions. **The interest on the United States bonds should have been included** unless they come within the exception mentioned in subdivision 4 of section 213b of the federal statute. It does not appear that they do. **Otherwise as to other interest. It forms no part of gross income and should not be considered.** As to the foreign taxes they were a proper business expense to be deducted from gross to find net income." (Emphasis supplied.)

The language of the decision in this case is broad enough to exclude income from obligations of all other states of the Union and their subdivisions in the measure of the New York corporate franchise tax even though income from certain federal securities were not exempt therefrom.

There does not seem to have been any concern evinced by the United States government or Congress over this preferment given to state and local obligations by this construction of the New York statute. No action was ever taken in any federal court to challenge this preferment of state obligations on the ground that it amounted to "unfriendly discrimination" against the United States in favor of securities in "substantial competition" with federal securities. Nor does it appear that this preferment interfered in any way whatsoever with the marketing of federal securities in the state of New York.

It is noteworthy that Justice Cardozo, then a member of the New York Court of Appeals, was one of the Justices who sat in the consideration of this case. The record shows that he concurred in all respects with this decision including the exemption of income from state

obligations and the inclusion of income from federal obligations in the measure of the New York tax. He merely dissented from that part of the majority opinion excluding foreign taxes paid from gross income in the computation of net income. Thus evidently in 1923, when this decision was rendered, Justice Cardozo who later wrote the dissenting opinion in the Schuylkill case, supra, did not believe that the exclusion of income from state securities from the measure of a corporate franchise tax, which did not also exclude income from federal obligations, constituted an "unfriendly discrimination" against the United States in favor of securities in "substantial competition" with federal securities.

The tax laws of the State of New York even to this day contain a provision giving to certain obligations of the State of New York a far greater preferment over federal securities in the field of corporate franchise taxation, than their mere exclusion from the measure of such a tax.

This provision is contained in section 190 of the Tax Law of New York, Title 59, McKinney's Consolidated Laws of New York, Annotated. It is as follows:

> "§190. PURCHASE OF STATE BONDS: CREDIT TO BE GIVEN
>
> Every corporation, company, association or taxpayer required by section one hundred eighty-seven, section one hundred eighty-nine or article nine-a, nine-b, or nine-c of this chapter to pay a tax which shall own any of the bonds of the state of New York, issued and sold prior to February tenth, nineteen hundred thirty-one, shall have credited to it annually to apply upon or in lieu of the payment of such tax an amount equal to one per centum of the par value of all such bonds of the state, bearing interest at a rate not exceeding three per centum per annum, owned by such corporation, company or association * * *."

In regard to the sections referred to in this provision, section 187 provides for the payment of a franchise tax

by insurance companies measured by a percentage of gross premiums paid by policyholders. Section 189 provides for an annual franchise tax on savings banks equal to six-tenths of one per cent of value or surplus and undivided earnings. Article 9-A provides for a franchise tax on ordinary business corporations based upon net income. The rate of this tax is 4½ per cent with a temporary increase to 6 per cent. Art. 9-B provides for franchise taxes on state banks, trust companies and other financial corporations based on net income at the rate of 4½ per cent plus a franchise tax of one mill on their capital. Article 9-C provides for taxation of national banking association franchises at the rate of 4½ per cent of net income.

Under section 190 of the New York tax law, the credit given to corporations in the payment of their franchise taxes amounts to one per cent of the par value of the New York bonds paying three per cent interest made eligible for this credit. The advantage derived from the mere exclusion from tax of income from a three per cent bond, in the case of a franchise tax of 4½ per cent, amounts to .14 of one per cent of the par value of the bond and, in the case of the temporary six per cent franchise tax to which the ordinary New York corporation is now subject, this advantage would be .18 of one per cent.

Thus the preferment given by this credit provision to those New York state bonds made eligible thereunder ranges from over seven to over five times as great as would be merely their exclusion from the income measure of the corporate franchise tax.

This provision of the New York Tax Law giving a credit to corporations owning certain state bonds, not allowed to corporations owning federal obligations, has been in effect ever since 1907. It has been amended a

number of times in ways not pertinent to this discussion. But in its essential respect, giving a credit to corporations owning New York state bonds not given to owners of federal bonds in corporate franchise taxation, it has been in effect continuously from 1907 to date.

Thus for a period of thirty-three years, the state of New York has been granting certain of its bonds a preferment over federal securities in the matter of franchise taxation many times as great as would be their mere exclusion from the measure of a franchise tax.

Cases involving the New York corporation franchise tax laws have been reviewed by this court in a number of cases. Among them are **Education Films Corp. v. Ward,** 51 S. Ct. 170, 282 U. S. 379, 75 L. ed. 400; also **Bass v. State Tax Commission,** 45 S. Ct. 82, 266 U. S. 271, 69 L. ed. 282. Yet none of the litigants have seen fit to raise the issue of discrimination against federal securities as a defense against the imposition of the New York tax.

New York is recognized as the most important financial state of the Union. If the tax policies of any state could interfere with the fiscal policies of the United States government, it would be those of New York. Yet during all of these thirty-three years, neither Congress nor any other agency of the United States government has ever evinced any concern over this matter. This provision was never thought of as interfering in any way with the marketing of federal securities in the state of New York.

It is clear from their inaction in this and other similar situations, that neither Congress nor the United States government has ever deemed that the exemption of state and local obligations from the measure of a tax, when this exemption was not given to federal securities, constituted an "unfriendly discrimination" against the United States or that such securities were in "substan-

tial competition" with federal securities so as to warrant either court or legislative action.

As a matter of fact, if the exclusion of income from state securities and the inclusion of income from federal securities in the measure of a tax constitutes an "unfriendly discrimination" in favor of local securities in "substantial competition" with federal securities, then Congress itself is also guilty of such a charge.

Congress has by specific legislation with this purpose in mind subjected most federal securities to surtax and excess profits taxation by the federal government, although the income from state and local governmental securities is not subject to such taxes.

Evidently, when it enacted such legislation Congress recognized the fact that the securities of the states and their local governmental subdivisions were not in substantial competition with federal securities. Congress, therefore, must have concluded that legislation having the effect of giving a preferment to state and local securities over federal securities in the matter of taxation would not interfere with the marketing of federal securities.

It is of course well recognized that the obligations of the United States government are far superior generally to state and local obligations in regard to safety and marketability. In reference to the obligations of local governments, the number of defaults in the payment of interest and principal thereon became so great that Congress found it necessary to enact legislation in an effort to deal with this problem.

The securities of state and local governments are also at a disadvantage as compared to federal securities in other ways, such as eligibility for investment by trust funds, and for use in the posting of public bonds, the tests for which they cannot meet as easily as federal securities.

States and their local subdivisions therefore frequently find great difficulty in marketing their securities. Hence, they seek to give investors some additional inducements besides merely a higher rate of interest. The most important of these inducements usually is exemption from taxation. The benefit of such exemption is primarily restricted to the state of issue; for states ordinarily do not exempt from taxation state and local securities other than their own.

From the revenue standpoint, **exemption from direct income taxation** offers no problem. The loss of revenue because of this exemption may be more than compensated for by higher prices and lower interest rates for state and local securities.

However, in the case of corporate franchise taxation a different situation may prevail. Federal securities, which are not subject to direct income and property taxation, may lawfully be included in the measure of a corporate franchise tax. If a state did not have the power to exempt its own securities from the measure of a franchise tax, without at the same time exempting federal securities, it might result in a great loss of revenue to the state, should it attempt to adopt such a policy.

In these difficult times, when the demands upon state treasuries are so great, but few states can afford to risk the loss of revenue which such a policy might entail, should the exemption of state obligations from franchise taxation have to be accomplished by a like exemption of federal obligations. If this were the law, it would effectively deter the various states from exempting their own and local governmental securities from measures of corporate franchise taxation. Thereby it would greatly restrict the states in their policy of exempting their own and local governmental securities from taxation, a policy which has always been considered lawful and proper.

The 1933 Minnesota Corporate franchise tax law is limited in scope. National and state banks, insurance companies and other institutional investors are exempted from the tax under the provisions of section 5 of the Act. It is the institutional investors that form the principal market for federal and state securities among corporations. The ordinary business corporation to whom this act applies has very little occasion for the purchase of such securities. Whatever surplus funds it has on hand are there but temporarily. They are held for use in the usual course of the business of the corporation. Such corporations cannot compete with financial institutions in the purchase of short term federal obligations as a temporary investment for surplus funds. These have now for a long time been selling at rates to yield less than one per cent per annum, which would hardly cover the overhead cost of making such a temporary investment by the ordinary business corporation.

The securities of the State of Minnesota and its local subdivisions can therefore, in no sense of the word, be said to compete with federal securities in the field of investment that is open to the ordinary business corporation to which the Minnesota corporate franchise tax principally applies.

It is, of course, clear that the State of Minnesota had no hostile intent against the United States when it exempted its own securities from the corporation franchise tax without at the same time exempting federal securities. Such a claim is patently absurd. Neither is there any serious competition between the obligations of the State of Minnesota and its local subdivisions and federal obligations. The granting of this exemption has in no way interfered with the marketing of federal securities in the State of Minnesota. The Minnesota corporate franchise tax has been in force since 1933. The decision of

the Minnesota Supreme Court to the effect that the inclusion of income from federal securities was invalid was rendered in December, 1939, over six years since the enactment of the law. Neither Congress nor the United States government have ever evinced any concern over this situation during this six-year period. This issue has only been raised by private interests in an effort to escape taxation.

In the cases now before this Court, there is no evidence whatsoever that the Securities of the State of Minnesota and its local subdivisions are in "substantial competition" with the securities of the federal government.

That the Minnesota Corporate Franchise Tax Law was enacted in the pursuit of ordinary public policy and is not an unfriendly discrimination against the United States is unquestionable. That this Act has in no way interfered with the marketing of Federal securities in the State of Minnesota is also unquestionable. The only question that might be raised is that the exclusion of interest from state and local obligations of the State of Minnesota, not allowed to interest from federal securities, may at some future time slightly interfere with the marketing of federal securities.

In answer, we point to the decisions of this court in similar situations involving alleged interference with Interstate Commerce. **Milk Control Board v. Eisenberg Farm Products,** 306 U. S. 346, 351, 352, 59 S. Ct. 528, 83 L. ed. 752. This court said:

> "Every state police statute necessarily will affect interstate commerce in some degree, but such a statute does not run counter to the grant of Congressional power merely because it incidentally or indirectly involves or burdens interstate commerce. This is so even though, should Congress determine to exercise its paramount power, the state law might thereby be restricted in operation or rendered unenforceable."

Situations of this sort are within the province of the **legislative function** as distinguished from the **judicial function** of the federal government.

As this court said in **South Carolina State Highway Department v. Barnwell Bros.,** 303 U. S. 177, 184, 185, 58 S. Ct. 510, 82 L. ed. 734:

> "Congress in the exercise of its plenary power to regulate interstate commerce, may determine whether the burdens imposed on it by state regulation, otherwise permissible, are too great, and may by **legislation** designed to secure uniformity or in other respects to protect the national interest in the commerce, curtail to some extent the state's regulatory power. But that is a **legislative,** not a **judicial,** function, to be performed in the light of the Congressional judgment of what is appropriate regulation of interstate commerce and the **extent** to which in that field, state power and local interests should be required to yield to the national authority and interest. In the absence of such legislation, the **judicial function,** under the commerce clause, Const. Art. 1, §8, cl. 3, as well as the Fourteenth Amendment, **stops** with the inquiry whether the state legislature in adopting regulations such as the present has acted within its province, and whether the means of regulation chosen are reasonably adapted to the end sought." (Emphasis supplied.)

We represent to the court that any casual interference with the marketing of federal securities that might at some future time result from this provision of the Minnesota Act is also within the province of the **legislative function** of the Federal government, and not of its **judicial function.**

In conclusion, we therefore respectfully submit to this court that subdivision (7) of Section 12 of the Minnesota Act, limiting the exclusion from the Minnesota tax on corporate franchises to income from obligations of the State of Minnesota and its governmental subdivisions, is not invalid as violative of the United States Constitution.

CONCLUSION

For the foregoing reasons, we respectfully submit that this court should grant writs of certiorari to review the final judgments herein of the Supreme Court of the State of Minnesota in each of the above entitled actions.

Respectfully submitted,

J. A. A. BURNQUIST,
Attorney General of the State of Minnesota,
Counsel for Petitioner,
102 State Capitol,
St. Paul, Minnesota.

JOHN A. PEARSON,
Special Attorney for the State of Minnesota,
E-901 First Nat'l Bank Building,
St. Paul, Minnesota,

IRVING M. FRISCH,
Special Attorney for the State of Minnesota,
416 Hodgson Building,
Minneapolis, Minnesota,

Of Counsel for Petitioner.